REPORT OF EXAMINATION
OF THE

EMPLOYERS DIRECT INSURANCE COMPANY

AS OF
JUNE 30, 2004

Filed April 7, 2005

TABLE OF CONTENTS

Los Angeles, California
February 4, 2005

Honorable John Garamendi
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

EMPLOYERS DIRECT INSURANCE COMPANY

(hereinafter also referred to as the Company) at the Company's statutory home office located at 30301 Agoura Road, Agoura Hills, California, 91301.

SCOPE OF EXAMINATION

The previous qualifying examination of the Company was made as of December 31, 2002. This examination covers the period from January 1, 2003 through June 30, 2004. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of June 30, 2004, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; corporate records; business in force by states; growth of Company; loss experience; accounts and records; and sales and advertising.

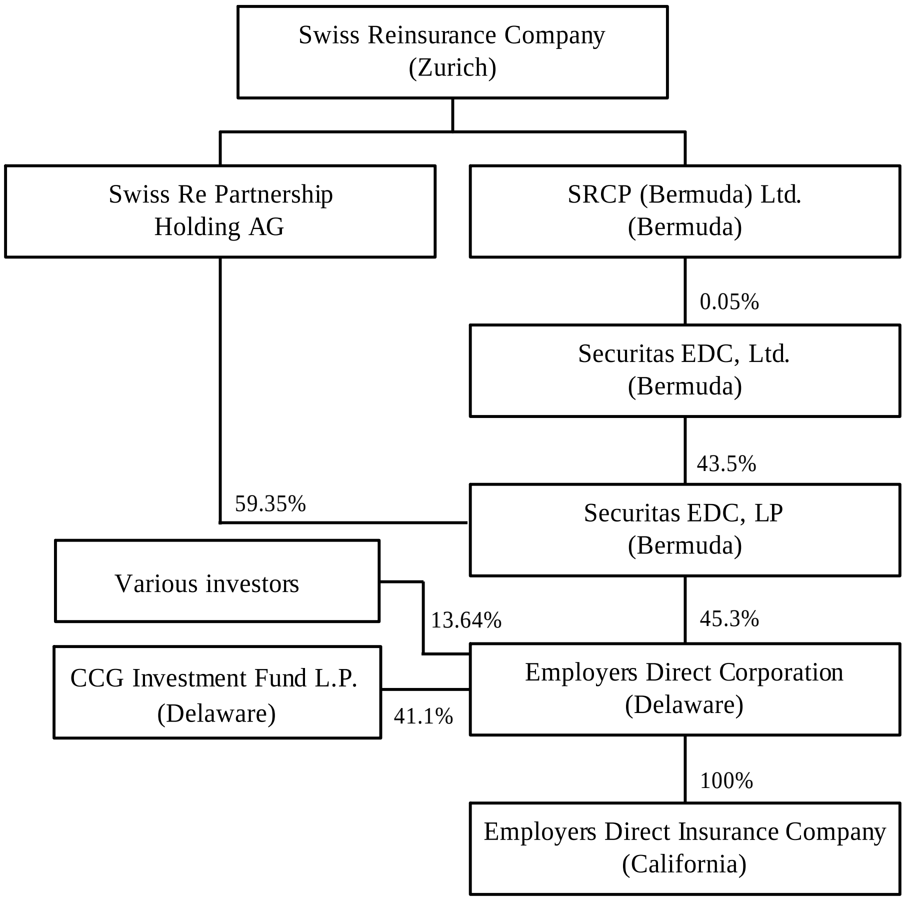
COMPANY HISTORY

The Company was incorporated in California on January 31, 2002 and commenced business on January 1, 2003. On December 31, 2002, the Company received its Certificate of Authority from the California Department of Insurance (CDI) as a licensed workers' compensation carrier.

The Company is a wholly-owned subsidiary of Employers Direct Corporation (EDC), a privately held company domiciled in the State of Delaware. EDC is owned by Securitas EDC, L.P. (45.3%) and CCG Investment Fund, L.P. (41.1%) with various other investors owning the remaining 13.6%.

MANAGEMENT AND CONTROL

The following abridged organizational chart, which is limited to the Company's parent along with its subsidiary insurance companies, depicts the Company's relationship within the holding company system as of June 30, 2004:



Management of the Company is vested in an eight-member board of directors elected annually. A listing of the members of the board and principal officers serving on June 30, 2004 follows:

Directors

Name and Residence	Principal Business Affiliation
James E. Little Agoura Hills, California	Chairman of the Board, President and Chief Executive Officer Employers Direct Insurance Company
Ronald A. Groden Agoura Hills, California	Vice Chairman of the Board, Chief Financial Officer, Treasurer and Secretary Employers Direct Insurance Company
Jesse Rogers San Francisco, California	Managing Director Golden Gate Capital, L.L.C.

Name and Residence	Principal Business Affiliation
Kenneth Diekroeger San Francisco, California	Managing Director Golden Gate Capital, L.L.C.
Russell Leatherby Newport Beach, California	Private Investor
Christopher McKechnie New York, New York	Senior Vice President Swiss Re Alternative Assets, L.L.C.
John Shettle Jr. Baltimore, Maryland	Chief Executive Officer Tred Avon Capital Advisors, Inc.
Michael McGraw Menlo Park, California	President and Chief Executive Officer The McGraw Group of Affiliated Companies

Principal Officers

Name	Title
James E. Little	President and Chief Executive Officer
Ronald A. Groden	Chief Financial Officer, Treasurer and Secretary
J. Hun Kim	Senior Vice President and Chief Actuary
Joseph Cardenas	Executive Vice President and Chief Information Officer
Denise Richardson	Vice President and Controller
Joyce Schulman	Vice President, Claims Department
Anne Bordwell	Vice President, Underwriting Department
June Duxler	Vice President, Human Resources Department
Jon Siglar	Vice President, Loss Control Department
Douglas Helm	Vice President, Marketing and Sales Department

Management Agreements

Asset Management Agreement: The Company entered into an Asset Management Agreement with Conning Asset Management Company as of November 2002 to invest the assets of the Company in accordance with the investment guidelines of the Company. The amount paid by the Company under the terms of this agreement during the examination period was $146,220.

Financial Advisory Agreement: The Company entered into a Financial Advisory Agreement as of August 22, 2002 with Securitas Capital, LLC to provide strategic and financial planning, budgeting, selecting and monitoring investment advisors and other services as needed. The amount paid by the Company under the terms of this agreement during the examination period was $140,725.

Tax Sharing Agreement: The Company entered into a Tax Sharing Agreement with Employers Direct Company (EDC) effective January 1, 2003. The method of allocation is based upon separate tax return calculations with current credit for the net tax losses to the extent utilized by the consolidated entities. Intercompany tax balances are settled in the quarter subsequent to the filing of the consolidated tax return.

Furniture Rental Agreement: The Company entered into an agreement with EDC effective April 15, 2003 to rent furniture through January 14, 2006. At the end of the agreement, the Company has the option to purchase the furniture from EDC for 10% of the original purchase price, which is $32,496. The amount paid by the Company under the terms of this agreement during the examination period was $134,852.

All the agreements have bee reported to the California Department of Insurance in its annual filing of its Registration Statement (Form B) under the Insurance Holding Company Act.

TERRITORY AND PLAN OF OPERATION

The Company writes workers' compensation insurance only in California through its direct sales force and does not generate business through agents or brokers. The Company's target market segments are policyholders that generate between $100,000 and $3 million in annual premium. In 2003 and the first half of 2004, the Company wrote $21.9 million and $43.6 million of direct premiums respectively.

The Company uses the California Workers' Compensation Insurance Rating Bureau's pure premium rates as the basis for its rate filings adjusted for the Company's underwriting and acquisition expenses and taking into account a policyholder's loss experience and individual risk characteristics. The

Company has been approved for and plans to issue deductible workers' compensation insurance policies in 2005.

REINSURANCE

Assumed

The Company has no reinsurance assumed.

Ceded

The following is a summary of the principal ceded reinsurance treaties inforce as of June 30, 2004:

Type of Contract	Reinsurer's Name	Company's Retention	Reinsurer's Maximum Limits
1st Excess of Loss (cancelled 06/30/2004)	American Reinsurance Company	$1 million each loss occurrence	$4 million each loss occurrence
1st Excess of Loss (effective 07/01/2004)	XL Re Ltd	$1 million each loss occurrence	$4 million each loss occurrence
2nd & 3rd Excess of Loss	Swiss Reinsurance America Corporation	$5 million & $10 million each loss occurrence	$5 million & $10 million each loss occurrence
4th Excess of Loss	AXIS Specialty Limited	$20 million each loss occurrence	$10 million each loss occurrence

These agreements cover all business classified by the Company as workers' compensation and employers' liability.

The first excess is with American Reinsurance Company effective the date the first policy was issued, but no later than January 1, 2003. The term is continuous with cancellation at the end of any calendar quarter with 90 days prior written notice. The reinsurer is liable for each and every loss above an initial ultimate net loss of $1 million, subject to a limit of liability to the reinsurer of $4 million excess of $1 million each and every loss. The Company cancelled the agreement June 30, 2004 and replaced it with the XL Re LTD agreement.

The second and third excess are with Swiss Reinsurance America Corporation effective the date the first policy was issued, but no later than January 1, 2003, and for a term of 18 months. The reinsurer is liable for each and every loss, above an initial ultimate net loss of $5 million in two layers. The first layer is subject to a limit of liability to the reinsurer of $5 million excess of $5 million, each and every loss, and the second layer is subject to a limit of liability to the reinsurer of $10 million excess of $10 million, each and every loss. The agreement was mutually cancelled effective December 31, 2003 and a new agreement was entered into with identical coverage levels and terms but with a lower ceded premium rate. The new agreement is effective January 1, 2004 and is for a term of 18 months.

The fourth excess is with AXIS Specialty Limited for policies inforce March 1, 2004 and for a term of 18 months. The reinsurer will be liable for each and every loss above an initial ultimate net loss of $20 million, subject to a limit of liability to the reinsurer of $10 million excess of $20 million, each and every loss.

Effective July 1, 2004, the Company entered into a contract with XL Re Ltd. (XL), an unauthorized reinsurer, for the first excess of loss reinsurance layer of $4 million excess of $1 million. XL agreed to establish a trust account for the sole use and benefit of the Company.

Effective November 15, 2004 through August 31, 2005, the Company entered into a contract for a reinsurance layer of $20 million excess of $30 million bringing the complete reinsurance program to $49 million excess $1 million. The layer was split evenly among three reinsurers – AXIS Specialty Limited, Endurance Specialty Insurance Ltd., and Swiss Reinsurance America Corporation.

As noted above, the Company entered into a reinsurance agreement with XL Re Ltd (XL), an unauthorized reinsurer. In order to take financial statement credit for this reinsurance, the Company is required to maintain collateral to secure the recoverables. California Insurance Code (CIC) Section 922.5 requires that the collateral for the non-admitted reinsurer shall be withheld or put into trust and be under the exclusive or sole control of the ceding insurer. In addition, CIC Section 10690 requires a deposit with the state by any company writing workers' compensation business in California. During the course of the examination, the Company was in compliance with CIC Section 922.5. However, it is awaiting a response from the California Department of Insurance with regards to CIC Section 10690.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of June 30, 2004

Underwriting and Investment Exhibit for the Quarter Ended June 30, 2004

Reconciliation of Surplus as Regards Policyholders
from December 31, 2002 through June 30, 2004

Statement of Financial Condition
as of June 30, 2004

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$ 73,901,482	$	$ 73,901,482	
Cash and short-term investments	16,347,127		16,347,127	
Interest, dividends, and real estate income due and accrued	766,594		766,594	
Agents' balances or uncollected premiums:				
Premiums and agents' balances in course of collection	1,359,472		1,359,472	
Premiums, agents' balances and installments booked but deferred and not yet due	1,114,022	111,402	1,002,620	
Accrued retrospective premiums	753,519		753,519	
Net deferred tax asset	4,152,226	1,094,700	3,057,526	
Electronic data processing equipment and software	616,504	374,512	241,992	
Furniture and equipment	108,768	108,768		
Health care and other amounts receivable	500		500	
Other asset nonadmitted	49,579	49,579		
Aggregate write-ins for other than invested assets	576,882	316,703	260,179	
Total assets	$ 99,746,675	$ 2,055,664	$ 97,691,011	

Liabilities, Surplus and Other Funds

Losses			$ 27,859,500	(1)
Loss adjustment expenses			5,118,889	(1)
Commissions payable, contingent commissions and other similar charges			474,026	
Other expenses			1,273,205	
Taxes, licenses and fees			2,985,151	
Current federal and foreign income taxes			598,021	
Unearned premiums			7,376,644	
Advance premium			63,478	
Ceded reinsurance premiums payable			1,730,662	
Remittances and items not allocated			81,685	
Aggregate write-ins for liabilities			110,888	
Total liabilities			47,672,149	
Common capital stock		$ 2,600,000		
Gross paid-in and contributed surplus		47,587,500		
Unassigned funds (surplus)		(168,638)		
Surplus as regards policyholders			50,018,862	
Total liabilities, surplus and other funds			$ 97,691,011	

Underwriting and Investment Exhibit
for the Quarter Ended June 30, 2004

Statement of Income

Underwriting Income		
Premiums earned		$ 37,983,217
Deductions:		
Losses incurred	$ 20,763,022	
Loss expense incurred	4,089,910	
Other underwriting expenses incurred	8,670,529	
Total underwriting deductions		33,523,461
Net underwriting gain		4,459,756
Investment Income		
Net investment income earned	$ 859,498	
Net realized capital gains	6,605	
Net investment gain		866,103
Other Income		
Net loss from agents' balances charged off	$ (188)	
Total other income		(188)
Net income before federal income taxes		5,325,671
Federal income taxes incurred		3,582,467
Net income		$ 1,743,204

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2003		$ 47,258,757
Net income	$ 1,743,204	
Change in net deferred income tax	1,730,548	
Change in nonadmitted assets	(713,647)	
Change in surplus as regards policyholders		2,760,105
Surplus as regards policyholders, June 30, 2004		$ 50,018,862

Reconciliation of Surplus as Regards Policyholders
from December 31, 2002 through June 30,2004

	Gain in Surplus	Loss in Surplus	
Surplus as regards policyholders, December 31, 2002, per Examination			$ 50,198,700
Net loss	$	$ 2,276,399	
Change in net deferred income tax	4,152,226		
Change in nonadmitted assets		2,055,655	
Totals	$ 4,152,226	$ 4,332,064	
Net decrease in surplus as regards policyholders			(179,838)
Surplus as regards policyholders, June 30, 2004, per Examination			$ 50,018,862

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

Based on an analysis by a Casualty Actuary for the California Department of Insurance, the Company's loss and loss adjustment expense reserves as of June 30, 2004 were found to be reasonably stated and have been accepted for purposes of this examination.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

The current report of examination has no comments or recommendations.

Previous Report of Examination

The previous qualifying examination had no comments or recommendations.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

/S/

Vivien Fan
Examiner-In-Charge
Associate Insurance Examiner
Department of Insurance
State of California